

Joint Release

Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency
Office of Thrift Supervision

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Shared National Credit Results Reflect Large Increase In Credit Commitment¹ Volume and Satisfactory Credit Quality

WASHINGTON — The volume of Shared National Credits (SNC) rose by 21% in 2006, the fastest pace since 1998, reflecting, in part, significant merger and acquisition lending, according to the SNC² review results released today by federal bank and thrift regulators.

The 2007 review noted an increase in the volume of criticized credits. However, the volume of criticized credits as a share of total SNC commitments remains low by historical comparison and is indicative of satisfactory credit quality. The review also included an assessment of underwriting standards and practices. Examiners found weakened underwriting standards in the syndicated lending market, particularly in non-investment grade or leveraged credit facilities.

The results of the review--reported by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision--are based on analyses prepared in the second quarter of 2007.

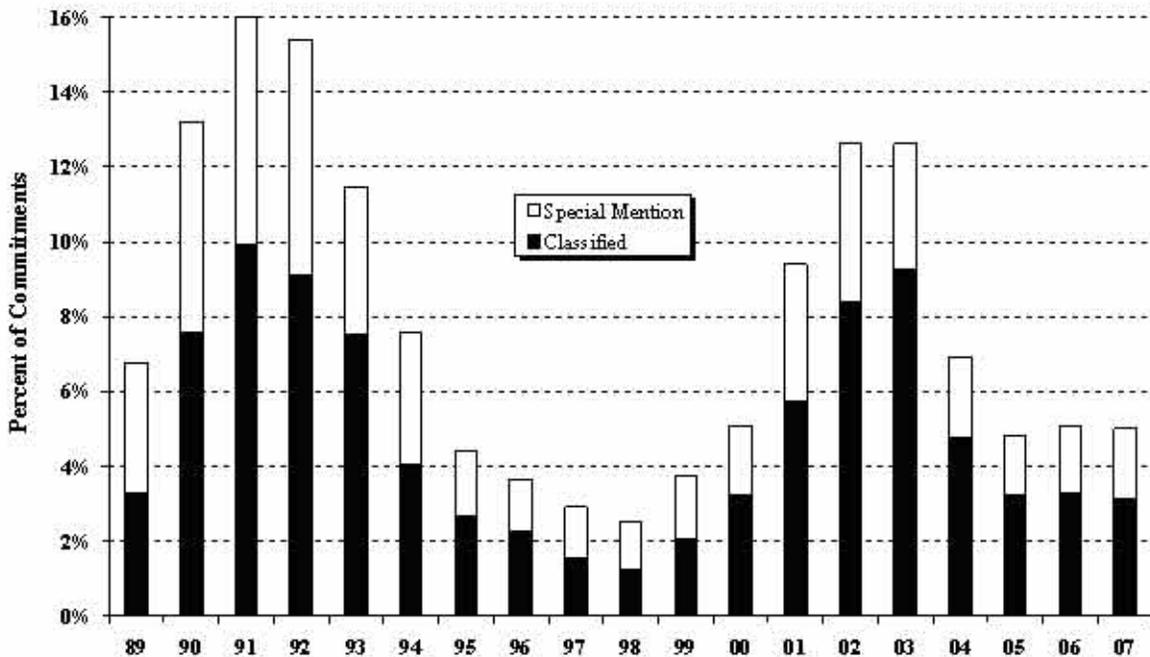
Criticized credits³ as a percent of total commitments fell slightly to 5.0 percent from 5.1 percent a year ago (see Chart 1). Similarly, the ratio of classified commitments to total commitments dropped slightly to 3.1 percent from 3.3 percent last year. Total classified commitments rose by \$9.7 billion, or 16 percent since 2006, with classified credits concentrated in the automotive and broadcast media sectors. Commitments rated special mention increased by \$9.1 billion, or 27 percent from 2006.

Classified commitments held by United States (U.S.) domiciled banking organizations increased to \$19.2 billion from \$13.1 billion in 2006, while the classified ratio was only 2.0 percent, a slight increase of 40 basis points. This percentage is substantially below the 3.1 classified percentage of the entire SNC portfolio as U.S. banks continue to hold a significantly lower volume of the classified loans.

Classified commitments held by nonbank entities increased to \$34.8 billion, representing nearly half of all classified credits. The volume of classified commitments held by nonbanks is particularly significant given their relatively small share (15.9 percent) of all SNC commitments.

These discussions of criticized credits and their ratios do not include the effects of hedging or other techniques that organizations often employ to mitigate risk.

Chart 1: Special Mention and Classified Credits



Overview

In aggregate, the 2007 SNC portfolio included 7,686 credits totaling \$2.3 trillion in credit commitments to 5,264 obligors. SNC commitments increased by \$401 billion, or 21.4 percent over 2006 results. This is the largest percentage increase since 1998. The portfolio's growth reflects, in part, substantial merger and acquisition financing provided during 2006 and into early 2007. Total outstandings, or drawn amounts, of \$835 billion were up 33.4 percent from the prior year, the largest increase in both dollar and percentage terms in the past 18 years. In addition, outstandings as a percent of total commitments increased from 33 percent in 2006 to 37 percent in 2007.

Criticized commitments rose to \$114 billion, but still remain less than half of their peak dollar level in 2002. Criticized credits represent a modest 5.0 percent of total commitments, about the same rate experienced over the past three SNC reviews.

SNCs classified substandard rose \$11.5 billion, or 20 percent from the 2006 review. The severity of the classified portfolio lessened this year as doubtful credits decreased \$1.3 billion, or 54 percent (see Table 1), and credits classified as loss fell \$400 million, a 34 percent reduction from the prior year. Nonaccrual⁴ classified credits fell 78 percent to \$3.9 billion, and only represent 0.2 percent of the SNC portfolio.

Table 1: SNC Criticized Commitments (\$ billions)

	Total Commitments							% Change 2006-2007
	2001	2002	2003	2004	2005	2006	2007	
Substandard	87.0	112.0	112.1	55.1	44.2	58.1	69.6	20%
Doubtful	22.5	26.1	29.3	12.5	5.6	2.5	1.2	-54%
Loss	8.0	19.1	10.7	6.4	2.7	1.2	0.8	-34%
Total Classified	117.5	157.1	152.2	74.0	52.5	61.8	71.6	16%
Percent of Commitments	5.7%	8.4%	9.3%	4.8%	3.2%	3.3%	3.1%	
Memo: Nonaccrual Classified	N/A	74.1	68.4	37.6	24.8	17.7	3.9	-78%
Special Mention	75.4	79.0	55.2	32.8	25.9	33.4	42.5	27%
Total Criticized	192.8	236.1	207.4	106.8	78.3	95.2	114.1	20%
Percent of Commitments	9.4%	12.6%	12.6%	6.9%	4.8%	5.1%	5.0%	
Total SNC Commitments	2,049	1,871	1,644	1,545	1,627	1,874	2,275	21.4%

Note: Figures may not add to totals due to rounding

Industry Trends

Credits in the Manufacturing sector continue to comprise the largest industry component of the SNC portfolio at \$570 billion, or 25 percent of total SNC commitments, followed by Financial Services and Insurance at 20 percent, and Oil, Gas, Pipelines, and Utilities at 12 percent.

While Construction and Real Estate and Lodging and Transportation experienced the highest growth rates at 50 percent and 38 percent, respectively, the Manufacturing sector had the largest volume growth at \$126 billion, or 31 percent of total growth in the SNC portfolio. Some of the larger subsector growth rates were in computer equipment, healthcare, and construction.

Criticized credits are heavily concentrated in the Manufacturing and Telecommunications and Cable (Telecom) sectors which again have the highest criticized and classified ratios. Together, these portfolios comprise 63 percent of total criticized credits and 72 percent of total classified credits.

Manufacturing criticized credits comprise 10.3 percent of the Manufacturing portfolio, an increase from 8.6 percent in 2006. This sector comprises 52 percent of total criticized credits and 59 percent of total classified credits compared to 41% and 43% respectively in 2006. The bulk of the criticized Manufacturing credits are concentrated in the automotive sector. Thirty-seven percent of the automotive sector is classified, representing 46 percent of total classified credits.

Telecom criticized credits comprise 8.9 percent of the Telecom portfolio, still high but an improvement from the 13.8 percent criticized rate in 2006. Telecom criticized credits comprise 11.3 percent of total criticized credits compared to 22% in 2006, and 13.5 percent of total classified credits compared to 24% in 2006. Over 85 percent of the Telecom criticized credits are in the broadcast media sector.

Trends by Entity Type

The portion of SNC commitments held by U.S. domiciled banking organizations edged down slightly from 44 percent to 43 percent, while the portion held by foreign banking organizations (FBOs) stayed at 41 percent (see Appendix C).

For more than a decade, lenders not regulated by the federal banking agencies or affiliated with banks, such as brokerage firms, mutual funds, insurance companies, and hedge funds, have taken on larger positions in the syndicated market. These nonbank institutions have increased their share to 16 percent of total commitments from 10 percent five years ago and 2 percent in 1996.

The quality of holdings also varied among entity types with classified commitments amounting to 2.0 percent of total commitments at U.S. banks compared with 1.9 percent at FBOs and 9.6 percent at nonbanks. Nonbank institutions continue to hold the largest portion of the SNC classified portfolio at 48 percent compared to 27 percent by U.S. banks and 25 percent by FBOs. U.S. bank holdings of classified

credits did, however, increase from 21 percent to 27 percent over the past year, and classified credits held by banks insured by the FDIC increased from 17 percent to 22 percent.

SNC Underwriting

Rapid portfolio growth, weakening of underwriting standards, and the increase in criticized credits over the past year are indicative of increased credit risk. As such, banking organizations should ensure that underwriting standards are not compromised by competitive pressures. Consistent with safe and sound banking practice, agent banks should underwrite funding commitments in a manner reasonably consistent with internal underwriting standards. Examiners noted a significant volume of loans with liberal repayment terms such as little to no amortization prior to maturity, reliance on refinancing as a primary source of repayment, and lack of meaningful financial loan covenants such as leverage and fixed charge coverage ratios. Examiners also noted the backlog of leveraged loan commitments that cannot currently be distributed without incurring potential market losses and may need to be retained in portfolio. In addition, banking organizations should ensure underwriting processes include a comprehensive repayment capacity analysis that demonstrates a borrower's ability to repay debt over a reasonable period of time.

Appendix A

Committed and Outstanding Balances (Dollars in Billions)								
Year	Special Mention	Sub-Standard	Doubtful	Loss	Total Classified	Total Criticized	Total Committed	Total Outstanding
1989	24.0	18.5	3.5	0.9	22.9	46.9	692	245
1990	43.1	50.8	5.8	1.8	58.4	101.5	769	321
1991	49.2	65.5	10.8	3.5	79.8	129.0	806	361
1992	50.4	56.4	12.8	3.3	72.5	122.9	798	357
1993	31.7	50.4	6.7	3.5	60.6	92.3	806	332
1994	31.4	31.1	2.7	2.3	36.1	67.5	893	298
1995	18.8	25.0	1.7	1.5	26.2	47.0	1,063	343
1996	16.8	23.1	2.6	1.4	27.1	43.9	1,200	372
1997	19.6	19.4	1.9	0.9	22.2	41.8	1,435	423
1998	22.7	17.6	3.5	0.9	22.0	44.7	1,759	562
1999	30.8	31.0	4.9	1.5	37.4	68.2	1,829	628
2000	36.0	47.9	10.7	4.7	63.3	99.3	1,951	705
2001	75.4	87.0	22.5	8.0	117.5	192.8	2,049	769
2002	79.0	112.0	26.1	19.1	157.1	236.1	1,871	692
2003	55.2	112.1	29.3	10.7	152.2	207.4	1,644	600
2004	32.8	55.1	12.5	6.4	74.0	106.8	1,545	500
2005	25.9	44.2	5.6	2.7	52.5	78.3	1,627	522
2006	33.4	58.1	2.5	1.2	61.8	95.2	1,874	626
2007	42.5	69.6	1.2	0.8	71.6	114.1	2,275	835

Appendix B⁵

Summary of Shared National Credit Industry Trends

(Dollars in Billions)

Industry	2001	2002	2003	2004	2005	2006	2007
Telecommunication & Cable							
Commitment	197.5	174.1	149.7	120.2	123.7	149.8	144.5
Classified	6.9	38.1	35.7	13.1	17.0	14.6	9.7
Special Mention	10.0	9.0	7.0	10.8	2.5	6.2	3.2
% Classified	3.5%	21.9%	23.8%	10.9%	13.7%	9.7%	6.7%
% Special Mention	5.0%	5.1%	4.7%	9.0%	2.0%	4.1%	2.2%
Manufacturing							
Commitment	540.5	494.8	424.4	400.1	409.7	444.3	570.2
Classified	58.1	60.9	42.6	19.6	10.7	26.4	42.2
Special Mention	27.0	26.2	22.8	6.9	16.6	12.2	16.8
% Classified	10.8%	12.3%	10.0%	4.9%	2.6%	5.9%	7.4%
% Special Mention	5.0%	5.3%	5.4%	1.7%	4.0%	2.7%	2.9%
Professional, Scientific, & Other Services							
Commitment	157.9	124.9	122.4	107.3	102.2	125.4	164.5
Classified	11.9	8.8	6.8	3.3	1.5	1.0	2.4
Special Mention	4.5	2.3	1.8	1.1	1.3	0.3	2.4
% Classified	7.5%	7.0%	5.5%	3.1%	1.5%	0.8%	1.5%
% Special Mention	2.8%	1.9%	1.5%	1.0%	1.3%	0.3%	1.5%
Oil, Gas, Pipelines & Utilities							
Commitment	222.8	229.5	200.5	175.7	186.4	208.9	261.5
Classified	4.3	17.1	38.1	24.2	14.1	9.7	4.5
Special Mention	7.0	15.5	12.3	10.1	1.9	2.0	0.7
% Classified	1.9%	7.4%	19.0%	13.8%	7.5%	4.6%	1.7%
% Special Mention	3.1%	6.8%	6.1%	5.8%	1.0%	1.0%	0.3%
Construction & Real Estate							
Commitment	100.1	96.7	87.5	90.2	107.9	124.0	186.2
Classified	4.7	4.1	3.6	2.5	0.7	0.4	2.9
Special Mention	1.9	3.2	2.3	0.9	0.3	0.6	2.3
% Classified	4.7%	4.2%	4.1%	2.8%	0.6%	0.3%	1.5%
% Special Mention	1.9%	3.3%	2.6%	1.0%	0.2%	0.5%	1.2%
Lodging & Transportation							
Commitment	99.1	82.9	74.8	74.1	76.5	80.8	111.7
Classified	3.1	6.6	7.7	5.2	3.7	2.5	0.7
Special Mention	6.7	5.3	1.8	0.7	0.8	4.5	1.1
% Classified	3.1%	7.9%	10.3%	7.1%	4.9%	3.1%	0.6%
% Special Mention	6.8%	6.4%	2.4%	1.0%	1.1%	5.6%	1.0%
Financial Services & Insurance							
Commitment	420.0	376.5	343.3	337.1	336.0	424.0	460.7
Classified	11.9	8.9	6.7	2.1	0.1	0.8	0.5
Special Mention	4.4	2.9	2.5	0.5	0.2	2.8	3.0
% Classified	2.8%	2.4%	1.9%	0.6%	0.0%	0.2%	0.1%
% Special Mention	1.1%	0.8%	0.7%	0.2%	0.1%	0.7%	0.7%
All Other							
Commitment	310.8	291.6	241.0	240.4	284.2	316.7	376.1
Classified	16.5	12.7	11.0	3.8	4.7	6.4	8.7
Special Mention	13.9	14.6	4.7	1.8	2.4	4.8	13.1
% Classified	5.3%	4.4%	4.6%	1.6%	1.6%	2.0%	2.3%
% Special Mention	4.3%	5.0%	2.0%	0.7%	0.8%	1.5%	3.5%
All Industries (Total)							
Commitment	2,048.9	1,871.0	1,643.5	1,545.2	1,626.7	1,873.9	2,275.4
Classified	117.5	157.1	152.2	74.0	52.5	61.8	71.6
Special Mention	75.4	79.0	55.2	32.8	25.9	33.4	42.5
% Classified	5.7%	8.4%	9.3%	4.8%	3.2%	3.3%	3.1%
% Special Mention	3.7%	4.2%	3.4%	2.1%	1.6%	1.8%	1.9%

Note: Figures may not add to totals due to rounding.

Appendix C: Exposures by Entity Type

Share of Total Commitments (%)

	2001	2002	2003	2004	2005	2006	2007
US Banking Institutions	46.2	45.3	45.4	46.5	44.8	44.3	42.7
Insured	43.8	42.8	42.5	43.4	41.5	40.8	38.9
Uninsured(*)	2.3	2.5	2.9	3.1	3.3	3.5	3.8
FBOs	45.4	44.8	43.8	41.6	42.1	41.5	41.4
Insured	5.0	5.1	5.4	5.5	6.0	6.2	6.4
Uninsured	40.4	39.7	38.4	36.1	36.1	35.3	35.0
Nonbanks	8.4	9.9	10.8	12.0	13.1	14.3	15.9

Total Classifications (\$ billion)

	2001	2002	2003	2004	2005	2006	2007
US Banking Institutions	48.5	53.7	43.6	18.8	11.9	13.1	19.2
Insured	43.9	47.6	37.8	16.0	8.6	9.0	13.2
Uninsured(*)	4.6	6.0	5.8	2.8	3.2	4.1	6.0
FBOs	44.0	60.0	65.0	31.3	15.5	17.3	17.6
Insured	7.3	8.4	6.8	2.8	1.5	1.6	2.3
Uninsured	36.7	51.6	58.3	28.5	14.0	15.7	15.4
Nonbanks	25.0	42.1	43.6	24.0	25.0	31.5	34.8
Totals	117.5	155.8	152.2	74.2	52.5	61.8	71.6

Classifieds as % of Commitments

	2001	2002	2003	2004	2005	2006	2007
US Banking Institutions	5.1	6.4	5.8	2.6	1.6	1.6	2.0
Insured	4.6	5.7	5.1	2.2	1.2	1.1	1.4
Uninsured(*)	0.5	0.7	0.8	0.4	0.4	0.5	0.6
FBOs	4.7	7.2	9.0	4.9	2.3	2.2	1.9
Insured	0.8	1.0	0.9	0.4	0.2	0.2	0.2
Uninsured	3.9	6.2	8.1	4.4	2.0	2.0	1.6
Nonbanks	14.4	22.9	24.5	13.0	11.7	11.8	9.6
Totals	5.7	8.4	9.3	4.8	3.2	3.3	3.1

Total Nonaccrual Commitments (\$ billion)

	2001	2002	2003	2004	2005	2006	2007
US Banking Institutions	n.a.	22.5	18.4	7.7	3.9	2.8	0.8
Insured	n.a.	19.4	16.5	0.1	3.1	1.8	0.5
Uninsured(*)	n.a.	3.1	1.9	7.6	0.8	1.0	0.3
FBOs	n.a.	30.5	29.5	17.6	9.0	4.7	0.9
Insured	n.a.	3.9	3.2	-	0.4	0.4	0.2
Uninsured	n.a.	26.6	26.3	17.6	8.6	4.3	0.7
Nonbanks	n.a.	21.1	20.5	12.3	11.9	10.2	2.2
Totals	n.a.	74.1	68.4	37.6	24.8	17.7	3.9

(*)Uninsured refers to organizations that do not take consumer deposits such as holding companies, brokerage firms, finance companies, etc.

Note: Figures may not add to totals due to rounding

¹Credits include syndicated loans and loan commitments, letters of credit, commercial leases, as well as other forms of credit. Credit commitments include both drawn and undrawn portions of credit facilities. This release reports only the par amounts of commitments; these may differ from the amounts at which loans are carried by investors.

²The Shared National Credit (SNC) Program was established in 1977 by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency. In 2001, the Office of Thrift Supervision became an assisting agency. With a few exceptions, the annual program, which seeks to provide an efficient and consistent review and classification of large syndicated loans, generally covers loans or loan commitments of at least \$20 million that are shared by three or more regulated financial institutions.

³Criticized credits are the total of credits classified substandard, doubtful, and loss – and credits rated special mention. Classified credits are only those rated substandard, doubtful, and loss. Under the agencies' Uniform Loan Classification Standards, classified credits have well-defined weaknesses, including default in some cases. Special mention credits exhibit potential weaknesses, which may result in further deterioration if left uncorrected.

Excerpt from federal banking agencies' examination manuals defining regulatory classifications: A Substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. An asset classified Doubtful has all the weaknesses inherent in one classified Substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Assets classified Loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value but rather that it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future. Amounts classified Loss should be promptly charged off.

Excerpt from the June 10, 1993 Interagency Statement on the Supervisory Definition of Special Mention Assets: A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

⁴Nonaccrual loans are defined for regulatory reporting purposes as "loans and lease financing receivables that are required to be reported on a nonaccrual basis because (a) they are maintained on a cash basis due to a deterioration in the financial position of the borrower, (b) payment in full of interest or principal is not expected, or (c) principal or interest has been in default for 90 days or longer, unless the obligation is both well secured and in the process of collection."

⁵NAICS groupings of industries identified in Appendix B are as follows: Telecommunication & Cable - 515 through 519; Manufacturing - 31 through 33 and 5121 through 5131; Professional, Scientific, & Other Services - 54, 55, 56, 61, and 62; Oil, Gas, Pipelines, & Utilities - 21 (oil- & gas-related only), 22, and 486; Construction & Real Estate - 23 and 53; Lodging & Transportation - 48 (excluding 486), 49, and 72; Financial Services & Insurance - 52; and All Other - remaining NAICS codes. Prior year data has been restated to reflect industry categorizations using 2002 NAICS groupings rather than 1997 NAICS groupings used in prior data releases.

Media Contacts:

FRB	Deborah Lagomarsino	(202) 452-2955
OCC	Kevin Mukri	(202) 874-5770
FDIC	David Barr	(202) 898-6992
OTS	William Ruberry	(202) 906-6677

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